EXPORT CREDIT SUBSIDIES

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL ECONOMIC POLICY AND TRADE

OF THE

COMMITTEE ON FOREIGN AFFAIRS
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CONTENTS

WITNESSES

APPENDIX

EXPORT CREDIT SUBSIDIES

WEDNESDAY, NOVEMBER 18, 1981

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY AND TRADE,
Washington, D.C.

The subcommittee met at 2:40 p.m. in room H-236, the Capitol, Hon. Jonathan B. Bingham (chairman of the subcommittee) presiding.

Mr. BINGHAM. The International Economic Policy and Trade Subcommittee will be in order.

We meet today to review the progress made in reaching agreement with other trading nations on the terms of export financing. Negotiations have been underway at the Organization for Economic Cooperation and Development (OECD) in Paris. The subcommittee has pending before it House Concurrent Resolution 95, calling on the President to try and secure an agreement that would significantly reduce export credit subsidies.[1] That resolution has been jointly referred to the Committees on Banking and on Ways and Means, both of which have reported it favorably. The issue of export subsidies will also arise when some members of this subcommittee and the Foreign Affairs Committee visit Paris on a study mission to Europe and the Middle East which I will lead. The delegation's schedule calls for meetings at the OECD with our Ambassador Katz, as well as the Secretary General of the Organization. So this testimony will serve as a briefing for the delegation on this particular issue. Further briefings on other aspects of the delegation's schedule will follow this hearing.

We are glad to have with us representatives of the Treasury and State Departments who have been directly involved in the recent export credit negotiations: John D. Lange, Acting Deputy Assistant Secretary of the Treasury for Trade and Investment Policy, and by Elinor G. Constable, Deputy Assistant Secretary for International Finance and Development of the State Department. Mr. Lange?

STATEMENT OF JOHN D. LANGE, ACTING DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TRADE AND INVESTMENT POLICY

Mr. LANGE. Thank you. Mr. Chairman.

Mr. Chairman, I would like to submit for the record my statement and summarize if you will permit me to.

[1] See appendix.

Mr. BINGHAM. Without objection, your statement will appear in full in the record.

Mr. LANGE. Thank you.

Let me start with an introductory statement: Whereas countries have been willing to reduce export subsidies in the General Agreement on Tariffs and Trade (GATT), they have found an escape valve in the area of export credits and have, until recently, been unwilling to reduce subsidies on export credits.

INTERNATIONAL ARRANGEMENT ON EXPORT CREDITS

The basic understanding that we have in the OECD concerning official export credits we refer to as the International Arrangement on Export Credits, a copy of which I will make available to the subcommittee upon request. This arrangement sets ground rules on minimum interest rates, maximum term, and maximum percent of the loan coverage permitted with official export credit support. It also refers to the use of so-called mixed credits, that is mixing aid and export credits. Most importantly, it establishes an information exchange system between export credit institutions which allows those institutions to match any offers by their competitors not in conformity with these ground rules.

Our long-term goal is to establish a system of differentiated interest rates where interest rates reflect the market rates for the five major SDR currencies—the dollar, deutsche mark, Japanese yen, French franc, and pound sterling. Most countries share this goal now. We want a system which would automatically adjust these rates as market rates move.

Foreign export credit subsidies recently have been among the most serious causes of distortion in international trade. In early 1980, the OECD estimated these subsidies at about $5.5 billion. Currently we estimate they would exceed $7 billion. If the outstanding export credits were refinanced today at today's cost of money to governments, the subsidy involved would be $7 billion—that is if they refinance it. This is a back-of-the-envelope way of measuring the subsidy. Both this administration, this committee, and the Congress in general, have placed a high priority on reducing these subsidies.

EFFORTS TO REDUCE EXPORT CREDIT SUBSIDIES

In October of this year we finally gained a breakthrough in reducing export credit subsidies. Twenty-two of the OECD countries agreed to raise the minimum export credit interest rates in most currencies from a norm of 7.75 percent for long-term loans to relatively poor countries to a new minimum of 10 percent. Subsidies in some currencies then will be reduced by as much as 30 to 40 percent. For the Japanese yen a separate minimum interest rate of 9.25 percent was agreed upon.

This represented the first modest international recognition of the principle that minimum export credit interest rates should relate to market rates in each currency. That is what is referred to as the system of differentiated rates.

Despite these modest successes, we are not at all satisfied that arrangement reform has gone far enough. Market interest rates in most currencies are well above the new 10-percent minimum. Even the World Bank lending rate is higher. The degree of subsidization permitted under the arrangement still is not much less than it was in mid-1980, due to the rise in financial market rates in the meantime. Further, we still have only the untested beginning of a procedure allowing regular, timely adjustment in arrangement rates to reflect market conditions; future changes must still be painstakingly negotiated. Finally, we would like to gain further discipline over the increasing use of mixed credits and to extend the arrangement to cover sectors—such as nuclear power—that are still not covered by its discipline.

The administration knows the benefits of exports to the U.S. economy. One of every eight manufacturing jobs, 1 of every 3 acres of farmland, and $1 of every $3 of U.S. corporate profits result from exports and the other international activities of U.S. firms. We have sought to promote exports by improving productivity in all sectors of the economy.

FOREIGN PARTNERS' REASONS FOR EXPORT CREDIT SUBSIDIES

The administration's economic program is designed to increase productivity in the United States and thereby increase price competitiveness internationally. Our foreign partners do not always see things in the same light. They have sought to retain their export credit subsidies because, among other reasons, the subsidies first, are thought to be a relatively cheap alternative to unemployment and welfare benefits; second, are portrayed as a form of economic assistance to LDC's; and third, promote industrial sectors to which the Government gives a high priority. In light of your trip to Paris in a few days, I thought it might be useful to address reflections on those points for the subcommittee.

The first and third points often reflect nothing more than a preference for State intervention in the economy—in this case, via subsidization. But enhancement of employment opportunities and expansion of favored industrial sectors via export subsidization may be purchased at a high price, for these subsidies do not necessarily facilitate efficient factor flows nor promote more efficient production. Rather, they may retard competitive adjustment to the realities of the marketplace by transferring resources from more productive to less productive sectors. The result can be to prolong inefficiency and undermine the principles of comparative advantage. Indeed, our competitors in the EC have implicitly acknowledged the futility of export credit competition among themselves by refusing to allow subsidized financing within the EC, even as they use it more extensively in trade with the rest of the world.

On the second point, regarding developing countries, it should be remembered that export credit subsidies accrue not solely to the importing country, but to the exporting company as well. Moreover, the LDC's that receive the largest shares of these subsidized credits are precisely the LDC's that require such resource transfers the least: The advanced developing countries, with ready access to commercial credit. Nor are the projects receiving official export finance always those that most help the LDC economies. Export credit subsidies are offered primarily to subsidize the industries of the exporting countries, rather than to serve sound development priorities in developing countries.

ATTEMPTS TO SECURE SECTOR AGREEMENTS

In addition to improving the international arrangement on export credits, we also are exploring the idea of special sector agreements among key producing countries in our efforts to reduce export credit subsidies.

As the subcommittee is aware, a large portion of the budget of the Eximbank goes for aircraft and nuclear power projects. It is in these areas where the international competition is the hottest. At the end of the summer, after about a year's negotiation or more, we adopted a common line on aircraft financing with our principal competitors in large commercial aircraft.

For the future, the U.S. Government is preparing a study in support of longer repayment terms for aircraft finance, which we shall discuss with the Airbus Industrie governments. The European Governments are resisting the idea of extending repayment terms for aircraft. However, both we and the U.S. aircraft industry believe that longer terms would be consistent with the economic life of most aircraft and would help reduce subsidies in this sector. I should add, the Airbus Industrie itself is favorably inclined toward this idea. We shall discuss the merits of guaranteeing private financing at terms longer than 10 years, and also seek to bring the minimum interest rates for aircraft further into line with financial market rates. I should clarify here that the interest rates would be on direct loans, but our ultimate goal would be to terminate any direct lending for large commercial jets and go only to an all-guarantee system and, therefore, not have need for borrowed moneys for Eximbank.

The second most important possible sector agreement after aircraft is one governing financing for nuclear powerplants. These plants may cost as much as a billion dollars apiece, while the minimum interest rates offered have been as low as 7.6 percent. Given the long construction period for the plants and the relatively long repayment periods for official finance, we estimate that the present value of the export credit subsidies may range from $200 million to $450 million per $1 billion of exported plant. Clearly, this is an area ripe for negotiation.

We intend to approach the other major nuclear power exporters before the end of the year with proposals similar to those put forward in the aircraft sector. It is too soon to tell what kind of reception we shall get from the other nuclear powerplant exporting countries at this time.

PENDING LEGISLATION

Now I would like to turn to what we call the war chest bills. Both Houses of Congress have demonstrated their support for the administration's negotiating efforts by introducing bills to establish interest rate subsidy funds with which to match the foreign competition in the event negotiations are not successful. Here in the House, the bill is H.R. 3228, introduced by Congressman Neal. We are grateful for the congressional support manifested by these initiatives.

Since we have just reached agreement on significant improvements in international export credit guidelines, the administration does not believe that enactment of these bills is needed at this time. They already have served their purpose in demonstrating the strong degree of political consensus behind the U.S. negotiating position.

In general, we would rather negotiate the reduction or elimination of international export credit subsidies, than emulate the practices of others ourselves. Should we not succeed in negotiating adequate further improvements in the arrangement in the spring of 1982, however, we may wish to reconsider this position.

We expect to continue working closely with Congress to formulate an approach which will be consistent with one, our budget realities, two, sound financial management, and three, our trade objectives.

For the convenience of the subcommittee, I have attached to my prepared statement a paper entitled "Export Credits, the Reagan Administration Policy for the Eighties." It sets out in greater detail the position I have just outlined for you today, Mr. Chairman.

Thank you for giving the Treasury Department the opportunity to testify on a matter considered of great economic importance to the United States.

[Mr. Lange's prepared statement follows:]

16-452 O - 83 - 2

Prepared Statement of John D. Lange, Acting Deputy Assistant Secretary of the Treasury for Trade and Investment Policy

Summary

Foreign export credit subsidies recently have been among the most serious causes of distortion in international trade. In early 1980, the OECD estimated these subsidies at about $5.5 billion. Using the OECD's methodology, a rough estimate is that they recently exceeded $7 billion. As a consequence, both this Administration and the Congress place a high priority on reducing these subsidies.

In October of this year, we finally gained a breakthrough in reducing export credit subsidies. Twenty-two of the OECD countries agreed to raise the minimum export credit interest rates in most currencies from a norm of about 7.75 percent for long-term loans to relatively poor countries, to a new minimum of 10 percent. Subsidies in some currencies thus will be reduced by 30 to 40 percent. For the Japanese yen and other currencies with commercial lending rates below the new 10 percent level, a separate minimum interest rate of 9.25 percent was agreed upon. This represented the first modest international recognition of the principle that minimum export credit interest rates should relate to market rates in each currency.

Despite these modest successes, we are not at all satisfied that Arrangement reform has gone far enough. Market interest rates in most currencies are well above the new 10 percent minima. The degree of subsidization permitted under the Arrangement still is not much less than it was in mid-1980, due to the rise in financial market rates in the meantime. Further, we still have only the untested beginning of a procedure allowing regular, timely adjustment in Arrangement rates to reflect market conditions; future changes must still be painstakingly negotiated. Finally, we would like to gain further discipline over the increasing use of mixed credits and to extend the Arrangement to sectors -- such as nuclear power -- that are still not covered by its discipline.

Role of Export Credits

The Administration knows the benefits of exports to the U.S. economy. One of every eight manufacturing jobs, one of every three acres of farmland, and one of every three dollars of U.S. corporate profits result from exports and the other international activities of U.S. firms.

We have sought to promote exports by improving productivity in all sectors of the economy. The Administration has stressed and will continue to stress an abiding reliance on market forces. For exports, this means the removal of disincentives. It also means the removal of artificial stimulants to trade, including subsidized export credits.

We are well aware that subsidized export credits, whether from the U.S. Eximbank or its foreign counterparts, distort trade and investment. The credits transfer resources from domestic taxpayers to exporters or to the importing country, without necessarily leading to any long-term improvement in the terms of trade. In fact, the short-term effect is to worsen the terms of trade by reducing the net return from the export.

Our foreign trading partners do not always see things in the same light. They have sought to retain their export credit subsidies because, among other reasons, the subsidies (1) are thought to be a relatively cheap alternative to unemployment and welfare benefits, (2) are portrayed as a form of economic assistance to LDCs, and (3) promote industrial sectors to which the government gives a high priority.

The first and third points often reflect nothing more than a preference for state intervention in the economy -- in this case, via subsidization. But enhancement of employment opportunities and expansion of favored industrial sectors via export subsidization may be purchased at a high price, for these subsidies do not necessarily facilitate efficient factor flows nor promote more efficient production. Rather, they may retard competitive adjustment to the realities of the marketplace by transferring resources from more productive to less productive sectors. The result can be to prolong inefficiency and undermine the principles of comparative advantage. Indeed, our competitors in the EC have implicitly acknowledged the futility of export credit competition among themselves by refusing to allow subsidized financing within the EC, even as they use it more extensively in trade with the rest of the world.

On the second point, regarding developing countries, it should be remembered that export credit subsidies accrue not solely to the importing country, but to the exporting company as well. Moreover, the LDCs that receive the largest shares of these subsidized credits are precisely the LDCs that require such resource transfers the least; most are advanced developing countries, with ready access to commercial credit. Nor are the projects receiving official export finance always those that most help the LDC economies. Export credit subsidies are offered primarily to subsidize the industries of the exporting countries, rather than to serve sound development priorities in developing countries.

Negotiating History

In meetings during December 1980 and May of this year, the United States, Japan and the EC were at a negotiating impasse. The EC offered grossly inadequate increases of 0.8 to 1.0 percent in the matrix, which would have brought the minimum rate for long-term loans for LDCs up to only 8.55 percent irrespective of currency. The United States and Japan preferred a system that would have tied minimum official export credit rates to the cost of money to governments in the various currencies.

In October of this year the EC made a more meaningful offer, which became the basis for an interim agreement. The compromise matrix, with the old rates in parentheses for comparison, is as follows:

Classification of Borrowing Country	Number of Years in Repayment 2-5	Over 5 to 8.5	Over 8.5 to 10
Relatively Rich	11.0%(8.5%)	11.25%(8.75%)	No credits
Intermediate	10.5%(8.0%)	11.0%(8.5%)	No credits
Relatively Poor	10.0%(7.5%)	10.0%(7.75%)	10.0%(7.75%)

There is a floor of 9.25 percent for loans in low interest rate currencies, such as the yen.

This compromise will affect all new export credit offers made on or after November 16.

Sector Agreements

We also are exploring the idea of special sector agreements among key producing countries in our efforts to reduce export credit subsidies.

The two most important sectors are large commercial aircraft and nuclear power. These sectors, for example, consumed 42 percent of Eximbank's direct loan budget in FY 1980 and 48 percent in FY 1981.

At the end of the summer, we adopted a common line on aircraft financing with our principal competitors in large commercial aircraft. It has the following major provisions: (1) a minimum U.S. dollar interest rate of 12 percent; (2) maximum ten-year, direct credit support of 62.5 percent or 42.5 percent, depending on the repayment schedules of private and official financing and (3) limits on the amount of official financial support which can be offered for spare parts. These terms apply only to exports to countries other than parties to the common line -- the United States, West Germany, the United Kingdom and France.

For the future, the U.S. Government is preparing a study in support of longer repayment terms for aircraft finance, which we shall discuss with the Airbus Industrie governments. The European governments are resisting the idea of extending repayment terms for aircraft. However, both we and the U.S. aircraft industry believe that longer terms would be consistent with the economic life of most aircraft and would help reduce subsidies in this sector. We shall discuss the merits of guaranteeing private financing at terms longer than ten years and also seek to bring the minimum interest rates for aircraft further into line with financial market rates.

Although we have focused up until now on commercial jet aircraft because these have been large consumers of the Eximbank budget, we are also concerned about export credit subsidies for general aviation aircraft. We have had informal conversations with some of the countries that produce these types of aircraft, and we intend to press for stronger controls over export credit subsidies in this area.

The second most important possible sector agreement after aircraft is one governing financing for nuclear power plants. These plants may cost as much as a billion dollars apiece, while the minimum interest rates offered have been as low as 7.6 percent. Given the long construction period for the plants and th relatively long repayment periods for official finance, we estimate that the present value of the export credit subsidies may range from $200 million to $450 million per billion dollars of exported plant. Clearly, this is an area ripe for negotiation.

We intend to approach the other major nuclear power exporters before the end of the year with proposals similar to those put forward in the aircraft sector. It is too soon to tell what kind of reception we shall get from the other nuclear power plant exporting countries.

<u>The "War Chest" Bills</u>

Both houses of Congress have demonstrated their support for the Administration's negotiating efforts by introducing bills to establish interest rate subsidy funds with which to match the foreign competition in the event negotiations are not successful. Here in the House, the bill was H.R. 3228, introduced by Congressman Neal. We are grateful for the congressional support manifested by these initiatives.

Since we have just reached agreement on significant improvements in international export credit guidelines, the Administration does not believe that enactment of these bills is needed at this time. They already have served their purpose in demonstrating the strong degree of political consensus behind the U.S. negotiating position.

In general, we would rather negotiate the reduction or elimination of international export credit subsidies, than emulate the practices of others ourselves. Should we not succeed in negotiating adequate further improvements in the Arrangement in the spring of 1982, however, we may wish to reconsider this position.

We expect to continue working closely with Congress to formulate an approach which will be consistent with our budget realities, sound financial management, and our trade objectives.

Next Steps

These changes in the international guidelines governing official export credits are the most significant since the Arrangement's predecessor agreements were inaugurated in 1975. We have reduced subsidization in areas covered by the Arrangement by as much as 40 percent. We have a useful common line on aircraft. To an extent, we have broken through the impasse on the export credit negotiations and established some basic principles. Other countries now accept the principle that export credit rates should not remain static in the face of movements in the financial markets. They also accept the principle that all currencies need not have the same minimum export credit interest rate. We have started the process of reform.

Nonetheless, we regard these achievements as only first steps towards our ultimate goal of a system that would (1) set minimum export credit rates at the cost of money to governments and (2) be revised automatically in response to financial market forces. The Arrangement's minimum rates still must be brought much closer to financial market rates. To have export credit agencies offering loans at rates (e.g., 10 percent) below those which the World Bank charges, currently 11.6 percent, is not justifiable.

The next step is to be taken at a special March 1982 meeting of the Participants to the Arrangement. Should financial markets remain at their current levels by the time of that meeting, the United States would propose another increase in the basic matrix rates to bring them much closer to market rates. We would also expect to find a better means of accommodating the countries, especially Japan, that are likely to have interest rates below this matrix. An artificial interest rate floor that bears little relationship to financial market rates cannot be expected to serve as a lasting means of avoiding friction in export credit competition.

Finally, as I have indicated, we need to continue to reduce subsidies in the aircraft sector by raising our common line's interest rates in all currencies closer to market rates of interest. We need stronger controls on export credit subsidies for general aviation aircraft. We need to find some means of reducing export credit subsidies for nuclear power plants. All of these points indicate that this Administration will continue to give high priority to reducing export credit subsidies.

For the convenience of the Committee, I have attached to my prepared statement a paper entitled "Export Credits: A Reagan Administration Policy for the '80s." It sets out in greater detail this position I have just outlined for you today. Thank you, Mr. Chairman, for giving Treasury this opportunity to testify on a matter it considers of great economic importance to the United States.

EXPORT CREDITS: A REAGAN ADMINISTRATION POLICY FOR THE '80s

Introduction and Overview

The United States is deeply involved in the world economy. Our economic interaction with areas beyond our own shores is increasing rapidly, and results in substantial economic gains:

1) In 1980, merchandise exports accounted for 8.5 percent of GNP while merchandise imports amounted to the equivalent of 9.5 percent. These figures represent more than a doubling of the share of trade in our national economy since 1970.

2) The United States is the world's largest exporter. In 1980, merchandise exports amounted to $220 billion while combined exports of goods and services reached $340 billion.

3) Total export-related employment in 1980 was 5.1 million, an increase of 75 percent over the 2.9 million export-related jobs in 1970. About 80 percent of these jobs -- 4.1 million -- were related to exports of manufactures, while nearly 900,000 were related to agricultural exports and another 142,000 to mining.

4) Put another way, one of every eight manufacturing jobs and one of every three acres of farmland are dedicated to exporting.

5) Finally, almost one of every three dollars of U.S. corporate profits now derives from the international activities of U.S. firms, including both their foreign investments and their exports.

The Reagan Administration is well aware of the benefits of trade for the U.S. economy. The potential for improved productivity, the increased employment opportunities, and the lower costs stemming from longer production runs are all among the considerations which have led us to make a commitment to a strong export policy.

That policy stresses above all the removal of both disincentives and artificial stimulants to trade, and reliance on market forces. It does not include artificial stimulation of exports through subsidized export credits, except where deemed absolutely necessary to counter certain foreign export credit subsidies. Indeed, we firmly believe that production for domestic consumption and production for export must be conducted under the same economic ground rules if our economy is to operate at maximum efficiency.

Export credit subsidies have the same distorting effect on trade and investment as import barriers or domestic subsidies. Similarly, once freed from such distortions, production for domestic consumption has the same stimulating economic effect as production for export. Both markets should be as free of government intervention as possible.

One reason export credit subsidies are pernicious is that they seem reasonable in an imperfect world. However, the subsidies have the effect of transferring resources from domestic taxpayers to exporters or to importing countries. They create a class of favored borrowers which enjoys governmental support in our credit markets, thereby influencing the allocation of credit and ultimately the direction of investment flows. To the extent that investment is thereby diverted from its most profitable uses, the long run return to capital also will be reduced. Moreover, export credit subsidies tend to benefit only some exporters, not all exporters. There is inequity as well as inefficiency in permitting some producers to receive credit at preferential rates, while others must pay the full market price for their borrowing.

Some observers have made the point that U.S. export credit subsidies are necessary to offset foreign export credit subsidies. The argument goes that U.S. capital and labor that would have gone to export markets in the absence of foreign subsidies are now forced to seek less productive returns in other markets. This is certainly true to a point, but does not indicate whether the cost of averting such resource shifts (i.e., through matching Eximbank subsidies) is offset by productivity gains. The best solution is to get rid of foreign export credit subsidies, not blindly match them.

Still other observers have suggested that officially-supported export credits can help improve the U.S. trade balance. But that effect can be only marginal and temporary under any budget which is now foreseeable. In FY 1980, the Export-Import Bank's direct loan disbursements amounted to about 1.4 percent of U.S. total merchandise exports, albeit

16-452 O - 83 - 3

a higher percentage in the capital goods sector. So even a major increase in Eximbank's direct loan budget -- a difficult proposition in the present fiscal environment -- would aid only a small proportion of total U.S. exports, and it would hardly affect our overall trade balance.

Improved Export Competitiveness

The foundation of the Administration's policy to improve U.S. export competitiveness is composed of measures which will improve productivity in all sectors of the economy, including the export sector. The Administration's economic program has four points:

1) A stringent budget policy to reduce the rate of growth in Federal spending.

2) A non-inflationary monetary policy, developed in cooperation with the Federal Reserve.

3) A regulatory reform program to eliminate unnecessary government regulations, thereby reducing business costs.

4) An incentive tax policy to increase the after-tax returns for saving and investment.

A stringent budget policy will mean increased reliance on the free market, with a reduction or elimination of those subsidies and regulations that reward inefficiency. We intend, as the President has said, to allow the private market to determine the activities in which it wants to invest. This will encourage efficient firms to expand, and their output will be available both at home and overseas at competitive prices, quality and servicing.

A policy of slow, steady growth in the money supply will substantially reduce inflation. As inflation rates decline, interest rates will follow. A low inflation rate will, over time, assure adequate price competitiveness of U.S. exports, while low interest rates will facilitate their financing. Thus, we expect significantly decreased demands on the Eximbank budget as U.S. interest rates decline.

A regulatory reform program that eliminates unnecessary constraints on productivity will also help exports by lowering costs of production, making U.S. goods and services more price competitive. In addition, the Administration is considering several policy proposals aimed specifically at easing the burden of export disincentives, in order to permit American firms to compete on a more equal footing with those of other countries.

A new tax program of Accelerated Cost Recovery will establish an improved system for writing off the costs of business investments. This will increase the incentives to invest, resulting in increased productivity and economic growth. Further, reductions in marginal tax rates for individuals will increase the flow of private savings to finance investment. These personal tax rate changes will encourage work effort and foster productivity growth. U.S. exports will increase as U.S. industry is able to expand, renovate and modernize its production facilities and as the tax burden on the U.S. economy is reduced.

The Role of the Export-Import Bank

In the context of our overall economic policy, the U.S. Export-Import Bank is needed to fight foreign official export credit subsidization and, when appropriate, to assume risks the private capital market is unwilling to take. It has a central role to play in supporting the negotiations to strengthen the International Arrangement on Export Credits. The Arrangement aims to limit and even eliminate the use of export credit subsidization by governments, which increasingly distorts international trade and capital markets. The magnitude of these subsidies was estimated by the OECD in early 1980 at as much as $5.5 billion, and we estimate them at over $7.0 billion now.

The Arrangement, and similar understandings on financing of aircraft and nuclear power plants, do not place adequate limits on export credit subsidies or provide means of enforcing such limits as are specified. Instead, most of the discipline in these understandings is provided by the threat of having subsidies matched by other parties, thereby denying export advantage to the subsidizing countries. By offering special subsidies in selected cases, Eximbank provides the United States a major tool with which to press for negotiated reduction in subsidies allowed under the Arrangement. An efficient and prudently used Eximbank, therefore, is needed to support U.S. exporters against the predatory financing practices of other governments, particularly in the capital goods sector.

Export Credit Subsidies

In early 1980, the OECD Secretariat estimated that export credit subsidies by the major OECD exporters in 1979 totalled $5.5 billion. Using the same methods, we roughly estimate the figure is over $7 billion for credits outstanding at the end of 1980. Some of the major countries and their estimated subsidies are:

Table 1*
(in millions of U.S. dollars)

	1979	1980 (est.)
France	$2,342	$3,070
United Kingdom	1,080	1,140
Japan	566	690
United States	315	660
Germany	215	370

Why Do Countries Subsidize Exports?

Our trade competitors have been reluctant to reduce their export credit subsidies for six main reasons:

First, many of these countries suffer trade or current account deficits. Rather than taking fundamental steps to redress the imbalances, such as allowing exchange rates to move freely, these countries prefer the more expedient if ultimately ineffective course of adopting export credit subsidies.

Second, their economic policies frequently are biased towards state intervention for favored sectors, among them the export sector. There is no natural repugnance for state intervention, no understanding that this course may only worsen their underlying competitive position.

Third, there seems to be a belief that credit subsidization will purchase increased exports and thus is a relatively cheap alternative to unemployment and welfare payments.

Fourth, many have what we would consider an irrational conviction that there is some "proper" or "natural" level for interest rates, unreflected in week-to-week, month-to-

* Subsidies were derived by the OECD Secretariat by multiplying official credits outstanding by the difference between yields on government bonds for a given currency and the minimum matrix rate. Extrapolations have been used to approximate the 1980 figures for official credits outstanding.

month or even year-to-year market fluctuations. These countries argue that stable and fixed export credit rates reflect this underlying "proper" level of interest rates.

Fifth, in an aggressive version of the infant industry argument, some countries wish (1) to help their industries increase their scales of production, (2) to overcome inefficiencies or other presumed disadvantages or (3) to encourage industrial sectors favored by the government.

And finally, there is a belief that export credit subsidies ease the debt burdens of the LDCs that receive the credits; export credits become a kind of foreign aid, in this view.

The U.S. view of export credits is markedly different from that of some of our trade competitors. We have pointed out to our trading partners that export credit subsidies, when they are met by offsetting subsidies abroad, usually do not change the competitive balance. For every French or British export credit subsidy, there may be a Japanese, Canadian or American export credit subsidy. The only result, in the end, is higher budgetary expenditures, higher taxes, and worsened effective terms of trade.

We have pointed out that a disciplined growth in the money supply, whatever its short run implications for interest rates, is necessary to control inflation. Controlling inflation will ultimately mean a far more stable level of interest rates than ill-conceived monetary intervention. To hold export credit rates or other preferred sector credit rates at an artificial, rigid level only prolongs the time needed to reach a true equilibrium position.

Using export credit subsidies to attempt to maintain employment artificially as an alternative to welfare or unemployment payments is short-sighted. Rather than enhancing factor flows to more efficient industries, the subsidies merely prolong the current inefficiencies and may be offset by other forces, such as an upward movement in exchange rates. The cost of the credit subsidies to the other sectors of the economy seems to be ignored. For these reasons, export credit subsidies may hinder rather than enhance export competitiveness over the long run.

The "infant industry" argument is also unpersuasive. There is no evidence that the public sector can pick export opportunities better than the private sector, witness the supersonic Concorde. In any case, the infant industry argument has occasionally been used by the governments of industrial countries which should have no need of it.

Finally, as to the LDC argument, it should be remembered that many export credit subsidies accrue not to the importing country alone, but to the exporting company. Moreover, the LDCs that receive the largest shares of these subsidized credits are precisely the LDCs that require such resource transfers the least; most are advanced developing countries. Nor are the projects receiving export finance always those that most help the LDC economies. Export credit subsidies are offered primarily to serve the favored industries of the exporting countries, rather than the interests of the developing countries.

Overall U.S. Negotiating Strategy

In our efforts to induce other countries to lower their export financing subsidies, the United States has found that simply matching foreign subsidies through Eximbank does not necessarily motivate change. Matching foreign subsidies is a helpful way of combatting the subsidies, but is not by itself decisive.

In the period 1977-1980, for example, direct credit authorizations by the Export-Import Bank increased nearly seven-fold, from $700 million to $4 billion. These loans were offered at rates well below the Bank's marginal cost of money and involved sizable subsidies (although Eximbank typically financed a smaller portion of a transaction at slightly higher interest rates than its competition). Yet we were no closer to an acceptable degree of discipline on export credit subsidies at the end of that period than we were at the beginning, because the political will to change was lacking.

To help create that political will, the Administration developed a coordinated program of policy instruments supporting our negotiating effort. The object was to give these negotiations maximum visibility in bilateral and multilateral contacts other than in the Export Credits Group. For example,

-- Secretaries Regan and Baldrige and Ambassador Brock stressed the importance of the credit subsidy issue in virtually every meeting with their counterparts in the countries participating in the negotiations.

-- The United States sought and won the commitment of the OECD Ministers to resolve this problem before the end of this year, and it also was discussed at the Ottawa Summit.

Domestically, the Administration has attempted to build the broadest possible consensus in favor of our negotiating position. The Commerce Department and USTR, with Treasury and Eximbank, convened a series of meetings with private industry to brief them on our strategy and to listen to their advice and comments. We also have met on a regular basis with congressional staff experts to ensure that you are well briefed on our actions and that we have your support. This is not merely a technical matter to be resolved by international financial experts. It is a matter of increased political concern.

To complement these political steps, the Executive Branch is considering the trade policy tools which might be available to support our negotiating effort -- for example,

-- whether and when to use remedies available in domestic trade legislation;

-- whether to initiate a trade complaint under the GATT or Subsidies Code dispute settlement provisions;

-- whether to institute a review in the GATT of the standing of export credit subsidies under the Subsidies Code.

The latter approach would be designed to extend the Subsidies Code's discipline to sectors such as nuclear power which has represented 20 to 25 percent of the dollar amount of Eximbank's loan authorizations in recent years, but which is not now subject to the Arrangement's interest rate discipline.

Arrangement Negotiations

The object of all these U.S. efforts for nearly three years has been to improve the International Arrangement on Export Credits by bringing its minimum interest rate requirements closer to financial market conditions. The first concrete result of our efforts appeared in 1980 when the Wallen Report, prepared by the Chairman of the OECD Export Credits Group, proposed two simple alternatives to the static and rigid interest rate matrix of the Arrangement.

The first was to weight the yields of government bonds in the five major trading currencies by their weights in the IMF's Special Drawing Right (SDR). The basket interest rate that emerged -- as the sum of the five weighted interest rates -- would be the new minimum export credit rate applicable to all currencies. This alternative was titled the Uniform Moving Matrix.

The second alternative, the Differentiated Rate System, would have used the secondary market yields on long-term government bonds to determine the minimum export credit rate for each country directly. Under either alternative, the minimum export credit rate would have been adjusted periodically to take account of financial market movements.

The United States indicated a preference for the Differentiated Rate System since it more effectively reduced export credit subsidies and is the more market-oriented system. Most other countries preferred the other system as a less drastic change from their traditional practices. One or two countries preferred no change at all.

Despite commitments made at both the 1980 OECD Ministerial and the 1980 Venice Summit to seek a solution, we found that the European Communities were able to offer no more than a trivial increase in interest rates in that year, with no change in the method for setting minima. The United States labeled this offer "grossly inadequate", but said we would accept it while continuing to press for a more equitable system on the lines of a differentiated rate system. However, Japan refused to be put in the position of having to charge a substantial premium for its export credits while other governments could continue to subsidize with impunity. As a result, no further changes were made in the Arrangement in 1980.

Recent Progress

After the May 1981 meeting of the Arrangement participants, which was little more than a replay of the December 1980 meeting, it was clear that the EC would have to revise its negotiating mandate if progress were to be made. In September of this year, the Council of EC Finance Ministers finally approved a mandate that began to take account of some of the financial market movements of the past year. The EC initially suggested that a matrix with minimum interest rates of between 9.5 and 9.75 percent for loans to LDCs should apply to most currencies.

The EC did concede that Japan, with financial market rates below those of most other countries, should be allowed to charge a minimum interest rate for the yen that was below this suggested matrix. As a means of offsetting Japan's apparent success in capital goods exports, however, the EC suggested that the Japanese Eximbank be forced to charge a premium above the rate used by Japanese commercial banks (the Long Term Prime Rate). The EC argued that this premium is justified because of the advantages to official lending. Among these advantages are 1) the assured availability of financing from official -- as opposed to private -- sources for exports, 2) official repayment maturities slightly longer than the private commercial banks could offer, 3) the ability to accept repayment risks that private lenders might be unwilling to accept, and 4) the ability of official institutions to offer a fixed interest rate that a buyer may have up to a year to accept or reject.

The United States felt that the EC position of 2.0 to 2.5 percent increases in the basic matrix rates was an exceptionally modest first step towards the ultimate goal of aligning official credit rates with market rates. As Chart 1 shows, an increase of 5 or 6 percent would have been preferable. The history of the negotiations made clear, however, that immediate increases of that magnitude were not likely to be accepted by the EC and many others, who feared disruption of export markets.

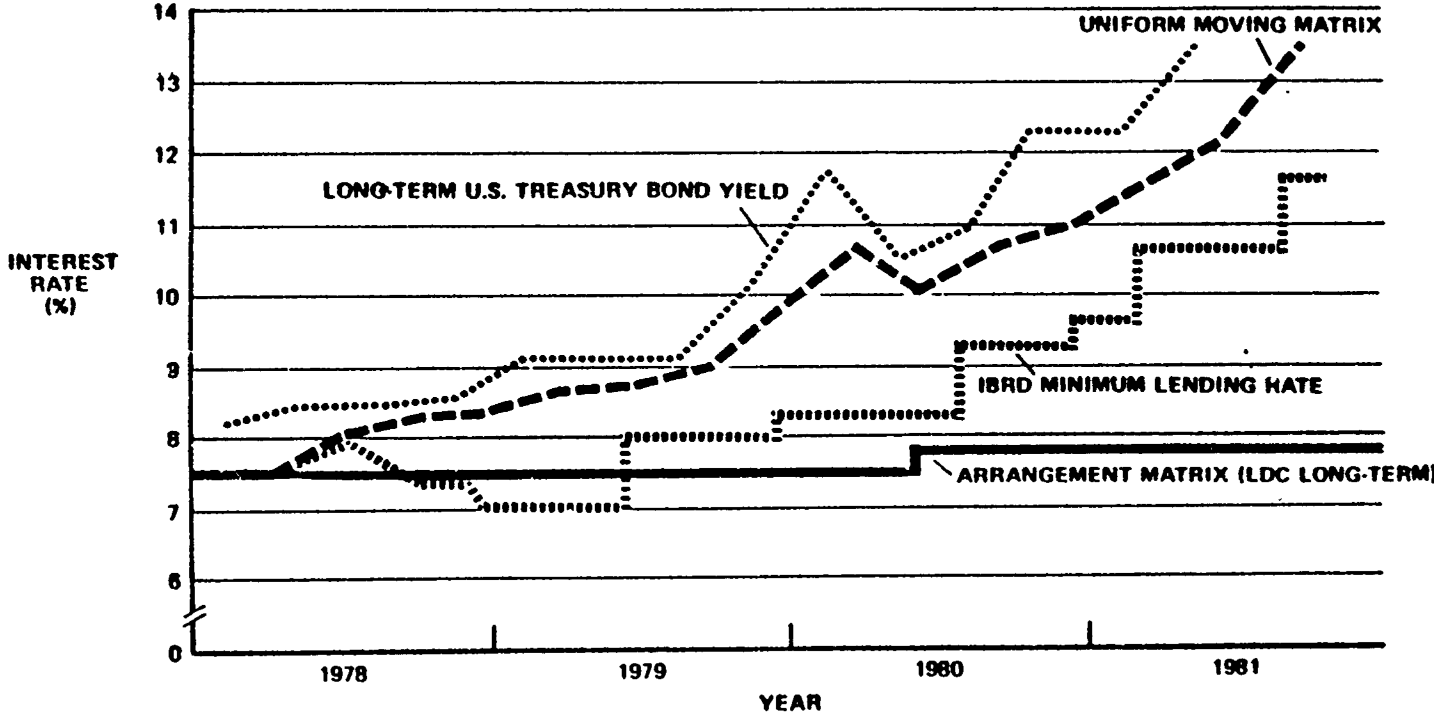
The United States therefore suggested that an increase in the matrix rates of 4 percent -- which would have brought the overall matrix up to about 12 percent -- would be much more acceptable. The EC demurred, but proposed a compromise to break the impasse. The matrix rates would be set somewhat higher than the EC had initially proposed, but somewhat lower than the United States would have preferred. In addition, a commitment was made to revise the rates further at a special meeting of the Arrangement participants, scheduled for March 1982, two months prior to the regular May meeting.

The compromise matrix was accepted on October 20 and will take effect Nov. 16. With the old minimum interest rates in parantheses for comparison, it stands as follows:

Table 2

	2-5 Years	5-8.5 Years	Over 8.5 Years
Rich Country	11.0% (8.5%)	11.25% (8.75%)	not applicable
Intermediate	10.5% (8.0%)	11.0% (8.5%)	not applicable
Poor Country	10.0% (7.5%)	10.0% (7.75%)	10.0% (7.75%)

LENDING RATES



Sources: IMF, International Financial Statistics;
OECD Arrangement Guidelines; IBRD.

Office of Trade Finance
U.S. Department of the Treasury
September 1981

The suggested minimum interest rate for the yen, (and other currencies that might have commercial lending rates below the new matrix rates) will be 9.25 percent.

Japan was concerned that it would be required to impose a negative subsidy on Japanese Eximbank lending, while countries with higher interest rates still would be free to subsidize to a degree. However, the obvious benefits of reducing the amounts of subsidies presently offered by its foreign, especially European, competitors induced the Japanese Government to accept the compromise.

Next Steps

The negotiated increases in the Arrangement matrix are the most significant changes since the inception of the Arrangement's predecessor agreements in 1975. Nonetheless, we regard these changes as only a first step towards our goal of a differentiated rate system, with minimum export credit rates set at the cost of money to governments and subsidization thus kept to a minimum.

The next step will be taken at the March 1982 meeting of the Participants. Should financial markets remain at their current levels by the time of that meeting, we would expect a substantial increase in the basic matrix rates to bring them much closer to the cost of money to governments.

We would also expect to find a better means of accommodating the countries that are likely to have interest rates below this matrix. An artificial interest rate floor that bears no relationship to financial market rates cannot be expected to serve as a lasting means of avoiding friction in export credit competition.

Sector Agreements

Another route that we have explored in our efforts to reduce subsidies is to pursue sector agreements for areas such as aircraft or nuclear power. These agreements could be exceptionally valuable inasmuch as a few sectors consume large amounts of the Eximbank budget. For example, the aircraft and nuclear power sectors combined consumed 42 percent of the Bank's budget in FY 1980 and 48 percent in FY 1981.

In early 1980, the U.S. Government began to discuss the idea of reducing export credit subsidies for large commercial jet aircraft with the British, French and German governments. These three governments provide the official export financing for the Airbus, the most important competitor against American producers of large aircraft. After lengthy talks spanning 18 months, all four governments were able to harmonize to reduce their practices o reduce export export credit subsidies for large aircraft.

The common line which all have unilaterally adopted has the following general provisions: (1) a minimum U.S. dollar interest rate of 12 percent, a minimum French franc interest rate of 11.5 percent and a minimum Deutschemark interest rate of 9.5 percent for official direct credit; (2) a normal maximum direct credit support of 62.5 percent or 42.5 percent of the total price, depending on the repayment schedules of intermixed private and official financing and (3) maximum spare parts support of 15 percent of the aircraft price for the first five aircraft of a type in a fleet, and 10 percent for the sixth and following aircraft.

American aircraft manufacturers have requested that the four countries consider allowing guarantee coverage -- that is, no direct official subsidization -- for private financing with repayment terms longer than the ten-year maximum in the OECD Aircraft Standstill. The manufacturers argue that the economic life of most aircraft is longer than 10 years and that official financing should reflect that longer life.

The members of the Airbus Industrie consortium have said they see "serious obstacles of principle and practice to such an extension in the repayment terms", while the U.S. Government has argued that it would help reduce subsidies.

The U.S. Government is preparing a study in support of longer repayment terms, which we shall discuss with the Airbus Industrie governments. The European governments have made it clear to us that any Eximbank offer of guarantees with a repayment period longer than ten years would mean that the other principles of the common line would not be respected by the European side.

The next step on the subject of sector financing will be made early next year, when we shall discuss with the Europeans the merits of guaranteeing private financing at terms longer than ten years. We shall also seek to bring the minimum interest rates for aircraft further into line with existing financial market rates.

Although we have focused up until now on commercial jet aircraft because these are large consumers of the Eximbank budget, we are also concerned about export credit subsidies for general aviation aircraft. We have had informal conversations with some of the countries that produce these types of aircraft, and we intend to press for stronger controls over export credit subsidies in this area.

The second most important possible sector agreement after aircraft is one governing financing for nuclear power plants. These plants may cost a billion dollars apiece, while the minimum interest rates offered have been as low as 7.6 percent. Given the long construction period for the plants and the relatively long repayment periods for official finance, we estimate that the present value of the export credit subsidies may range from $200 million to $450 million per billion dollars of exported plant. The nominal subsidies over the life of the loan may even approach the initial export value of the plant. As an example, an annual interest rate subsidy of 8 percent for a nuclear power plant worth $1 billion could equal $950 million in nominal subsidies over the life of the loan. Clearly, this is an area ripe for negotiation.

We intend to approach the other major nuclear power exporters before the end of the year with proposals similar to those put forward in the aircraft sector. It is too soon to tell what kind of reception we shall get from the other nuclear exporting countries.

Conclusion

In summary, we have taken important strides torward reducing export credit subsidies, reducing the subsidies in areas covered by the Arrangement by as much as 40 percent. We have a useful informal common line on aircraft.

We have broken through the impasse on the export credit negotiations and established some basic principles. Other countries now understand that export credit rates should not remain unchanged despite movements in the financial markets. They also understand that all currencies need not have the same minimum export credit interest rate. We have started the process of reform.

However, much remains to be done. The Arrangement's minimum rates must be brought much closer to financial market rates. To have export credit agencies offering loans at rates (e.g., 10 percent) below those which the World Bank charges, currently 11.6 percent, is ludicrous.

We need to continue to reduce subsidies in the aircraft sector by raising our common line's rate from 12 percent for dollars to 14 or 15 percent. We need stronger controls on export credit subsidies for general aviation aircraft. We need to find some means of reducing export credit subsidies for nuclear power plants. All of these points indicate that this Administration will continue to give high priority to reducing export credit subsidies.

November 1981

Mr. BINGHAM. Thank you very much.
Ms. Constable.

STATEMENT OF ELINOR G. CONSTABLE, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL FINANCE AND DEVELOPMENT, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS, DEPARTMENT OF STATE

Ms. CONSTABLE. I too have a prepared statement for the record. With your permission, however, I will summarize it.

Mr. BINGHAM. Please do.

Ms. CONSTABLE. Particularly in view of the fact that a number of sections are quite repetitive of what Mr. Lange said.

We are happy to be here to share with you our thoughts on some of the positions. We certainly share the view that officially supported financing at subsidized rates has become a particularly troublesome form of trade subsidy and we need to do something about it.

PROBLEMS CREATED BY SUBSIDIZATION

The practice of subsidizing credits is a problem for a number of reasons. They are not only a major expense to governments, but they also impose undesirable trade distortions. For example, noncompetitive suppliers may seek attractive financing packages to overcome their weaknesses in technology and price, a process that may lead to a number of distortions and lower productivity. I think it is important, though, to recognize that we are not opposed to all forms of official export finance. The workings of the market for financing exports are very imperfect. Official intervention is necessary to reduce the effects of the imperfection if we are to realize the benefits of trade on a large scale.

The unique risks and difficulties in assessing the international marketplace make it difficult, if not impossible, for the private sector alone to provide the long-term, fixed-rate financing needed to sell internationally, especially in the developing countries. It is appropriate for governments to try and neutralize the barriers created by these risks by means of official guarantees, insurance, and in some cases direct credit. Our opposition comes when these activities go beyond market imperfections and become general subsidy programs.

Mr. Lange reviewed the history of our negotiations and the arrangement in 1975, and the fact that rising interest rates and other events made the levels which were agreed to at that time inappropriate for the current situation. We have also reviewed for you the recent history of the negotiations and the agreement which we have reached. We agree that this is a significant step. It is, however, only a first step, and it is very important that we pursue further the objective of limiting the subsidies.

I would like, however, to emphasize our view that the manifestation of our seriousness in Export-Import Bank policies may have been an important factor helping to bring those countries wedded to the use of export credit subsidies to the negotiating table. The Export-Import Bank has a legislative mandate to meet foreign financing competition. Previously, when there were few budgetary constraints on the Bank, it did so on a broad front. This practice may have helped to convince some countries that there was little competitive advantage to be gained by subsidizing credits. Even when the need to get our budget under control led to reduced authority, Eximbank policies were able to support our negotiating arguments by meeting the competition selectively.

Giving our strongest support to the most important cases and those involving our most uncooperative partners can be almost as effective as a broadly based attack. The existence of the so-called war chest bill, H.R. 3228 and S. 828 have also been helpful. They provided the necessary evidence of strong congressional support, and certainly the threat of a $1 billion subsidy fund could not be disregarded.

PROGRESS IN NEGOTIATIONS

We, however, agree that it is not necessary to enact these bills at the time based on progress in the negotiation, and the fact that one budgetary burden would be extremely large. The agreement we have reached, as I said, represents significant progress. It is important that it should not be diminished. However, it is only a first step. We need to go much further. If interest rates remain at current high levels, we will expect further substantial increases in minimum interest rates when the participants in the arrangement meet again in the spring.

There is some basis for optimism. There appears to be a growing recognition on the part of other participants that the cost of export credit subsidies has gotten out of hand. Furthermore, export credit agencies are increasingly aware that any competitive edge is likely to be nullified by at least some participants matching a subsidized offer. In any case, we remain committed to the following basic goals: To set minimum interest rates for export credits at the level of cost of borrowing to governments, and to have the rates adjusted automatically in response to changing financial market conditions. We also hope to attack the problem of subsidized export financing in areas not covered in the agreement as described by Mr. Lange. I want to underscore the importance of that particular effort and the fact that in the nuclear field, in particular, we think that we should explore the possibilities for some sort of agreement. You are familiar with the provisions of the recent agreement on aircraft.

Export credit subsidies are a problem primarily related to the large gamut of manufactured exports. As you know, there are certainly many sensitive issues in agricultural trade, but discrepancies among exporters' credit terms is not a major source of friction or a source of trade distortions. I raise this point parenthetically because some interest was expressed earlier on this point. The distinction between commercial agricultural credits of 3 years or less, and concessional credits of 10 years or more, is generally accepted and observed by agricultural exporters. However, having said that, I think we should point out that direct export subsidies on agricultural products, particularly by the European Community, do pose a serious and growing problem to agricultural trade.

SUPPORT FOR LEGISLATION

This committee among others is considering a concurrent resolution on the question of export credit subsidies. That resolution was of course drafted before the recent success in revising the arrangement. Nevertheless, it does represent a clear statement of the objectives shared by the administration and Congress of eliminating the practice of subsidized export credits. Although clearly it is not necessary to exhort the President to use all means to reach this goal, passage of this resolution might provide a useful indication to our competitors of the strength of our convictions and the unity of views among the President and the Congress on this issue.

Thank you, Mr. Chairman.

[Ms. Constable's prepared statement follows:]

PREPARED STATEMENT OF ELINOR G. CONSTABLE, DEPUTY ASSISTANT SECRETARY OF STATE FOR INTERNATIONAL FINANCE AND DEVELOPMENT, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS

INTRODUCTION

THE US HAS LONG BEEN ONE OF THE LEADING PROPONENTS OF A FREE AND OPEN INTERNATIONAL TRADING SYSTEM. WE BELIEVE THAT INTERNATIONAL MARKET MECHANISMS SHOULD BE ALLOWED TO WORK WITHOUT ARTIFICIAL CONSTRAINTS AND INCENTIVES. THE TRADE FLOWS THAT RESULT FROM MARKET FORCES HELP TO ENHANCE PRODUCTIVITY AND WELFARE AND TO KEEP PRICES LOW.

OUR CONVICTIONS ABOUT THE BENEFITS OF THE FREEST POSSIBLE TRADE HAVE LED US TO JOIN WITH OTHER TRADING COUNTRIES IN EFFORTS TO LOWER TARIFFS AND REDUCE NON-TARIFF BARRIERS WHENEVER POSSIBLE. WE CONSIDER IT EQUALLY IMPORTANT TO AVOID THE TRADE-DISTORTING EFFECTS OF EXPORT SUBSIDIES. IN THE COURSE OF THE TOKYO ROUND OF TRADE NEGOTIATIONS, WE AGREED TO A NEW SUBSIDIES CODE TO DISCIPLINE ON THE USE OF SUBSIDIES. NEVERTHELESS, MANY TYPES OF SUBSIDIES REMAIN A PROBLEM.

OFFICIALLY SUPPORTED EXPORT FINANCING AT SUBSIDIZED RATES HAS BECOME A PARTICULARLY TROUBLESOME FORM OF SUBSIDY. THE OECD ESTIMATES THAT THE COST OF SUBSIDIZED EXPORT CREDITS TO THE INDUSTRIALIZED COUNTRIES WAS SOME $5.5 BILLION IN 1980. WITH HIGHER INTEREST RATES, THE AMOUNT COULD RISE SIGNIFICANTLY.

WE ARE DETERMINED TO END THE PRACTICE OF SUBSIDIZED EXPORT CREDITS. THEY ARE NOT ONLY A MAJOR EXPENSE TO GOVERNMENTS, BUT THEY ALSO IMPOSE UNDESIRABLE TRADE DISTORTIONS. NON-COMPETITIVE SUPPLIERS SEEK ATTRACTIVE FINANCING PACKAGES TO OVERCOME THEIR WEAKNESSES IN TECHNOLOGY AND PRICE. INDIVIDUAL FIRMS AND EVEN ENTIRE INDUSTRIES BECOME DEPENDENT ON SUBSIDIZED

FINANCING TO MAINTAIN AND ENHANCE THEIR MARKET POSITION. THEY BECOME LESS PRODUCTIVE AND LESS INNOVATIVE, YET THERE IS NO INCENTIVE TO INVEST OR IMPROVE PRODUCTS. THE MOST INNOVATIVE AND EFFICIENT EXPORTERS FIND LITTLE TO BE GAINED BY THEIR EFFORTS WHEN SUPERIORITY IN QUALITY AND PRICE IS NEUTRALIZED BY FINANCING. INVESTMENT AND RESEARCH ARE SHIFTED TO OTHER LINES.

I DO NOT WANT TO LEAVE THE IMPRESSION THAT WE ARE OPPOSED TO ALL OFFICIAL EXPORT FINANCE. THE WORKINGS OF THE MARKET FOR FINANCING EXPORTS ARE VERY IMPERFECT. OFFICIAL INTERVENTION IS NECESSARY TO REDUCE THE EFFECTS OF THE IMPERFECTION IF WE ARE TO REALIZE THE BENEFITS OF TRADE ON A LARGE SCALE. THE UNIQUE RISKS AND DIFFICULTIES OF ASSESSING THEM IN THE INTERNATIONAL MARKET PLACE MAKE IT DIFFICULT, IF NOT IMPOSSIBLE, FOR THE PRIVATE SECTOR ALONE TO PROVIDE THE LONG TERM, FIXED RATE FINANCING NEEDED TO SELL INTERNATIONALLY, ESPECIALLY IN THE DEVELOPING COUNTRIES. IT IS APPROPRIATE FOR GOVERNMENTS TO TRY TO NEUTRALIZE THE BARRIERS CREATED BY THESE RISKS THROUGH THE USE OF OFFICIAL GUARANTEES OR INSURANCE AND, IN SOME CASES, DIRECT CREDITS. OUR OPPOSITION COMES WHEN THESE ACTIVITIES GO BEYOND OVERCOMING MARKET IMPERFECTIONS AND BECOME GENERAL SUBSIDY PROGRAMS.

BACKGROUND

AS EARLY AS 1975, WE WORKED WITH THE OTHER INDUSTRIAL COUNTRIES TO SET GUIDELINES FOR OFFICIAL EXPORT FINANCING. OUR EFFORTS WERE AIMED AT LIMITING THE ROLE OF EXPORT FINANCING IN COMPETITIVE SITUATIONS. FINANCIAL MARKET CONDITIONS WERE SUCH THAT SIMPLY SETTING MINIMUM INTEREST RATES AND GUIDELINES FOR REPAYMENT TERM WAS ADEQUATE FOR OUR PURPOSE. SUBSEQUENT FINANCIAL MARKET DEVELOPMENTS CHANGED THE PICTURE DRAMATICALLY.

INTEREST RATES ROSE TO RECORD LEVELS AND FINANCING BECAME A MORE CRITICAL FACTOR IN INTERNATIONAL TRADE. THE MINIMUM RATES SET ORIGINALLY WERE FAR TOO LOW FOR THE NEW CONDITIONS, IMPLYING LARGE SUBSIDIES OF EXPORT CREDITS.

WE SOUGHT INCREASE IN THESE MINIMUM RATES, BUT MANY OF OUR PARTNERS IN THE ARRANGEMENT SAW THINGS IN A DIFFERENT LIGHT. THEY SOUGHT TO RETAIN THEIR EXPORT CREDIT SUBSIDIES ARGUING THAT EXPORT CREATED JOBS WERE CHEAPER THAN UNEMPLOYMENT AND WELFARE BENEFITS, THEY PROMOTE IMPORTANT INDUSTRIAL SECTORS AND THAT THEY TRANSFER RESOURCES TO LDCS. OTHER COUNTRIES DO NOT FULLY SHARE OUR VIEWS ON THE ECONOMIC INEFFICIENCIES IMPLICIT IN THE FIRST TWO ARGUMENTS. THEY ARE RELUCTANT TO ACKNOWLEDGE THE PLAIN FACT THAT THE BULK OF EXPORT CREDITS GO TO THE WEALTHIEST LDCS.

DESPITE EXTENSIVE NEGOTIATIONS, WE WERE AT AN IMPASSE AS LATE AS MAY OF THIS YEAR. MINIMUM RATES UNDER THE ARRANGEMENT AT THAT POINT RANGED FROM 7.5 PERCENT FOR THE POOREST COUNTRIES TO 8.75 FOR THE RICHER COUNTRIES. THE EUROPEAN COMMUNITY COULD NOT AGREE TO INTEREST RATE INCREASES OF MORE THAN 0.8 TO 1.0 PERCENT, WHICH WOULD HAVE YIELDED A NEW MINIMUM OF 8.55 PERCENT. MARKET RATES OF INTEREST WERE 14-15 PERCENT OR MORE. THE US AND JAPAN SOUGHT A FULL SCALE REVISION OF THE GUIDELINES THAT WOULD HAVE TIED EXPORT CREDIT RATES TO MARKET INTEREST RATES IN THE VARIOUS CURRENCIES.

IN OCTOBER, THE EC MADE A NEW OFFER. ON THAT BASIS, A COMPROMISE WAS HAMMERED OUT THAT PROVIDES INCREASES OF 2.25-2.5 PERCENT, WITH LOANS IN LOW INTEREST CURRENCIES AT MARKET RATES, PROVIDED THE RATE DOES NOT GO BELOW A FLOOR OF 9.25 PERCENT. THE REVISED ARRANGEMENT WENT INTO EFFECT NOVEMBER 16 AND

ALSO INCLUDES PROVISIONS STRENGTHENING CONSTRAINTS ON THE USE OF MIXED CREDITS.

THE USE OF MIXED CREDITS -- CREDIT PACKAGES COMBINING HIGHLY CONCESSIONAL DEVELOPMENT AID WITH REGULAR EXPORT FINANCING -- HAS BECOME AN INCREASING PROBLEM. THE NEW GUIDELINES WOULD REQUIRE PRIOR NOTIFICATION OF THE USE OF SUCH CREDITS WITH A GRANT ELEMENT OF UP TO 25 PERCENT. EXPERIENCE SUGGESTS SUCH NOTIFICATION COULD SIGNIFICANTLY REDUCE THE USE OF MIXED CREDITS BY PUTTING COUNTRIES ON NOTICE THAT THEIR EFFORTS WOULD BE MATCHED.

THE MANIFESTATION OF OUR SERIOUSNESS IN EXPORT-IMPORT BANK POLICIES MAY HAVE BEEN AN IMPORTANT FACTOR HELPING TO BRING THOSE COUNTRIES WEDDED TO THE USE OF EXPORT CREDIT SUBSIDIES TO THE NEGOTIATING TABLE. THE EXPORT-IMPORT BANK HAS A LEGISLATIVE MANDATE TO MEET FOREIGN FINANCING COMPETITION. PREVIOUSLY, WHEN THERE WERE FEW BUDGETARY CONSTRAINTS ON THE BANK, IT DID SO ON A BROAD FRONT. THIS PRACTICE MAY HAVE HELPED TO CONVINCE SOME COUNTRIES THAT THERE WAS LITTLE COMPETITIVE ADVANTAGE TO BE GAINED BY SUBSIDIZING CREDITS. EVEN WHEN THE NEED TO GET THE BUDGET UNDER CONTROL LED TO REDUCED AUTHORITY, EXPORT-IMPORT BANK POLICIES WERE ABLE TO SUPPORT OUR NEGOTIATING EFFORTS BY MEETING THE COMPETITION SELECTIVELY. GIVING OUR STRONGEST SUPPORT TO THE MOST IMPORTANT CASES AND THOSE INVOLVING OUR MOST UNCOOPERATIVE PARTNERS CAN BE ALMOST AS EFFECTIVE AS A BROADLY-BASED ATTACK.

THE EXISTENCE OF THE SO-CALLED WAR CHEST BILLS (H.R. 3228 AND S.828) MAY ALSO HAVE BEEN HELPFUL. THEY PROVIDED EVIDENCE OF STRONG CONGRESSIONAL SUPPORT, AND THE THREAT OF A BILLION DOLLAR SUBSIDY FIND COULD NOT BE DISREGARDED. WE DO NOT

BELIEVE THESE BILLS SHOULD BE ENACTED AT THIS TIME. WE HAVE MADE PROGRESS IN NEGOTIATIONS, AND THE BUDGETARY BURDEN WOULD BE LARGE.

FURTHER STEPS

THE AGREEMENT WE HAVE REACHED REPRESENTS SIGNIFICANT PROGRESS. ITS IMPORTANCE SHOULD NOT BE DIMINISHED. HOWEVER, IT IS ONLY A FIRST STEP. EVEN THE NEW RATES ARE WELL BELOW CURRENT MARKET RATES. IF INTEREST RATES REMAIN AT THESE HIGH LEVELS, WE WILL EXPECT FURTHER SUBSTANTIAL INCREASES IN MINIMUM INTEREST RATES WHEN THE PARTICIPANTS IN THE ARRANGEMENT MEET AGAIN IN THE SPRING. THERE IS SOME BASIS FOR OPTIMISM. THERE APPEARS TO BE A GROWING RECOGNITION ON THE PART OF OTHER PARTICIPANTS THAT THE COST OF EXPORT CREDIT SUBSIDIES HAS GOTTEN OUT OF HAND. FURTHERMORE, EXPORT CREDIT AGENCIES ARE INCREASINGLY AWARE THAT ANY COMPETITIVE EDGE IS LIKELY TO BE NULLIFIED BY AT LEAST SOME PARTICIPANTS MATCHING A SUBSIDIZED OFFER.

IN ANY CASE, WE REMAIN COMMITTED TO OUR BASIC GOALS.

-- FIRST, TO SET MINIMUM INTERESTS RATES FOR EXPORT CREDITS AT THE LEVEL OF THE COST OF BORROWING TO GOVERNMENTS; AND

-- SECOND, TO HAVE THE RATES ADJUSTED AUTOMATICALLY IN RESPONSE TO CHANGING FINANCIAL MARKET CONDITIONS.

WE ALSO HOPE TO ATTACK THE PROBLEM OF SUBSIDIZED EXPORT FINANCING IN AREAS NOT COVERED BY THE AGREEMENT. THIS PAST SUMMER WE MADE A FIRST BREAKTHROUGH IN THIS FRONT WHEN WE REACHED AN UNDERSTANDING WITH THE KEY AIRBUS PARTNERS ON THE FINANCING OF LARGE COMMERCIAL AIRCRAFT. THESE AIRCRAFT WERE EXCLUDED FROM THE COVERAGE OF THE ARRANGEMENT, BUT WERE NONETHELESS A SIGNIFICANT FACTOR IN THE LOAN PORTFOLIOS OF EXPORT CREDIT AGENCIES. IN RECENT YEARS, THEY HAVE CONSUMED AMOUNTS APPROACHING ONE-HALF OF EXIMBANK'S DIRECT LENDING.

THE COMMON LINE WE HAVE ADOPTED WITH OUR COMPETITORS PROVIDES FOR:

-- A MINIMUM INTEREST RATE OF 12 PERCENT IN DOLLARS;

-- TEN YEAR REPAYMENT TERMS;

-- DIRECT CREDIT SUPPORT OF 42.5 OR 62.5 PERCENT, DEPENDING ON REPAYMENT SCHEDULES; AND

-- LIMITS ON COVERAGE OF SPARES.

THE EUROPEANS ALSO AGREED TO STUDY THE POSSIBILITY OF ADOPTING A LONGER TERM MARKET-RATE SYSTEM FOR FINANCING AIRCRAFT.

WE ARE NOW BEGINNING TO LOOK AT ANOTHER SECTOR EXCLUDED FROM THE ARRANGEMENT: NUCLEAR POWER. BECAUSE OF THEIR HIGH

PRICE TAG AND THE EXTENDED CONSTRUCTION AND REPAYMENT SCHEDULES FOR NUCLEAR POWER PLANTS, FINANCING TERMS CAN BE A DECIDING FACTOR IN COMPETITION. AT PRESENT HIGH INTEREST RATES, FINANCING COSTS CAN EXCEED THE COST OF THE PLANTS THEMSELVES. AT SUBSIDIZED INTEREST RATES, FINANCING NUCLEAR POWER PLANT EXPORTS CAN BE AN IMMENSELY COSTLY EXERCISE FOR OFFICIAL EXPORT CREDIT AGENCIES.

WE INTEND TO APPROACH OTHER NUCLEAR POWER PLANT EXPORTERS IN THE NEAR FUTURE. WE CANNOT PREDICT THEIR REACTIONS, BUT WE ARE HOPEFUL WE CAN AGREE TO A COMMON LINE IN A FASHION SIMILAR TO WHAT HAS BEEN DONE ON AIRCRAFT.

EXPORT CREDIT SUBSIDIES ARE A PROBLEM PRIMARILY RELATED TO THE LARGE GAMUT OF MANUFACTURED EXPORTS. AS YOU KNOW THERE ARE CERTAINLY MANY SENSITIVE ISSUES IN AGRICULTURAL TRADE, BUT DISCREPANCIES AMONG EXPORTERS' CREDIT TERMS IS NOT A MAJOR SOURCE OF FRICTION OR A SOURCE OF TRADE DISTORTIONS. THE DISTINCTION BETWEEN COMMERCIAL AGRICULTURAL CREDITS OF THREE YEARS OR LESS, AND CONCESSIONAL CREDITS OF TEN YEARS OR MORE IS GENERALLY ACCEPTED AND OBSERVED BY AGRICULTURAL EXPORTERS.

HOWEVER, I WISH TO TAKE THIS OPPORTUNITY TO POINT OUT THAT DIRECT EXPORT SUBSIDIES ON AGRICULTURAL PRODUCTS, PARTICULARLY BY THE EC, POSE A SERIOUS AND GROWING PROBLEM

TO AGRICULTURAL TRADE. BY PAYING RESTITUTIONS TO AGRICULTURAL EXPORTERS, THE EC ALLOWS THE EXPORT OF MANY AGRICULTURAL COMMODITIES WHICH ARE SUPPORTED WITHIN THE EC AT PRICES WELL ABOVE WORLD MARKET LEVELS. THESE EXPORT SUBSIDIES CREATE DISTORTIONS IN AGRICULTURAL TRADE AND DISADVANTAGE OUR OWN EXPORTERS. AGRICULTURAL SUBSIDY PRACTICES ARE OF MAJOR CONCERN TO THIS ADMINISTRATION, AND WE ARE ACTIVELY PURSUING A RESOLUTION OF THIS PROBLEM BOTH BILATERALLY AND MULTILATERALLY.

H. CON. RES. 95

THIS COMMITTEE, AMONG OTHERS, IS CONSIDERING A CONCURRENT RESOLUTION ON THE QUESTION OF EXPORT CREDIT SUBSIDIES. THAT RESOLUTION WAS DRAFTED BEFORE THE RECENT SUCCESS IN REVISING THE ARRANGEMENT, AS CAN BE SEEN FROM SOME OF THE PREAMBULAR LANGUAGE. NEVERTHELESS, IT REPRESENTS A CLEAR STATEMENT OF THE OBJECTIVE, SHARED FULLY BY THE ADMINISTRATION AND CONGRESS, OF ELIMINATING THE PRACTICE OF SUBSIDIZED EXPORT CREDITS. ALTHOUGH CLEARLY IT IS NOT NECESSARY TO EXHORT THE PRESIDENT TO USE ALL MEANS TO REACH THIS GOAL, PASSAGE OF THIS RESOLUTION MIGHT PROVIDE A USEFUL INDICATION TO OUR COMPETITORS OF THE STRENGTH OF OUR CONVICTIONS AND THE UNITY OF VIEWS AMONG THE PRESIDENT AND CONGRESS.

MEASUREMENT OF SUBSIDIES

Mr. BINGHAM. Thank you very much.

Except for your last mention there of the rates applicable to aircraft, I do not have any sense of the numbers here. Is there any way that you can give us that kind of thing, a little bit of what the magnitudes of these subsidies are and how far they——

Mr. LANGE. Mr. Chairman, on page 5 of the attachment——

Mr. BINGHAM. I am not sure I have the attachment.

Mr. LANGE. It is in the statement.

Mr. BINGHAM. We do not have that.

Mr. LANGE. We have extra copies here. I apologize for the oversight.

The chairman of the export credits group, the president of the Swedish Export Credit Agency, Mr. Axel Wallen, asked the OECD staff to give a rough estimate of what these subsidies amount to. There are many ways to measure a subsidy. It might be the way we do in Congress in terms of money, how much actual cash appropriations are necessary from the Treasury to accomplish something. The OECD staff felt that a good measure might be to recognize that market rates of interest for long-term Government securities—in other words, costs or money to governments—have accelerated very sharply in France, the United States, the United Kingdom, and that they have even been variable in Germany and Japan. The staff said, look, if you took all the outstanding loans from every one of these export credit agencies today—and some of these loans may be out at interest rates of 6 percent, 4 percent, 8 percent, the cost of borrowing against those loans may have averaged out historically at 8 percent—the staff said if you had to refinance everything today at the present minimum interest rates, what would be the subsidy involved. That would be the current, real measure of a subsidy, and that is reflected in the table, on page 5 of the attachment. It is disaggregated by five major countries.

If you look at the 1980 numbers, the subsidy adds up to the $5.5 billion that I gave you in testimony. France, as you see, has a subsidy element of $3.1 billion; United Kingdom, $1.1 billion; Japan, $1 million; the United States, $1 billion; and Germany, $400 million. We used the same methodology for 1981 that was used in the 1980 calculations of the OECD. That does not measure what it actually costs the budgets of the treasuries of these governments. Those costs, of course, are somewhat less.

TERMS OF THE ARRANGEMENT

Mr. BINGHAM. Now, the agreement that has been reached—what is the character of that agreement? That does not require ratification, I assume.

Mr. LANGE. No, sir. It was formerly called the gentlemen's agreement, and that is really in a generic sense what it is. It is an informal guideline that everyone would observe, and if countries did not observe it, it would become worthless. The reason it was done that way rather than as a treaty, which would essentially hammer it into stone, was to keep it flexible enough to work it into something really meaningful, and this has yet to be done.

Mr. BINGHAM. Why was the export of nuclear plants excluded from the arrangement originally?

Mr. LANGE. Members were unable to reach agreement on the nuclear-power sector, especially in regards to term. The long suit for the U.S. Export-Import Bank is going out in terms in excess of 10 years. We can do that because Treasury can borrow at 15 or 20 years and intermediate for Eximbank. It is difficult for the Europeans to go out beyond 7 years. So the compromise was made, all right, we will go to 10. We refused to go down to 10 years on nuclear power because the amount of money and time it takes to get those plants going, to get them paying for themselves and become economically viable—given the elecric power rate structures that are normal for the electric power sector in any country—a 15-year loan term seemed to be to us appropriate.

Mr. BINGHAM. But the figures you have given us on page 5 of your statement indicate a very large amount in terms of what the export credit subsidies could be per plant.

Mr. LANGE. That is right, sir, yes.

Mr. BINGHAM. That is very large.

Mr. LANGE. It is very large. If a bank has a loan out for 10 years or 15 years and it has a construction period before the loan actually starts getting repaid, and that may be 5 or 10 years, it ends up having a 20- to 25-year repayment of interest. Now, the differential of course between the cost of money to the Government and the interest rate paid by the borrower over such a long period of time is such that you could come up with that kind of subsidy.

Mr. BINGHAM. Mr. Lagomarsino.

EUROPEAN REACTION TO ARRANGEMENT

Mr. LAGOMARSINO. Why do you think the Europeans finally agreed to go for a more acceptable figure?

Mr. LANGE. They agreed in part because it is costing their budgets, also. There is a new government in France now. They have had to reassess their priorities as to where they put government funds for particular purposes. It has cost the British Government dearly to do this kind of thing, and I think they are beginning to feel the budget squeeze nearly as much as we do.

Ms. CONSTABLE. That is a very important point. At least in part there was uncertainty about what we would do and that added to what Mr. Lange suggested about the cost of the subsidies.

Mr. LAGOMARSINO. They were worried about the costs and thought it might even go higher?

Ms. CONSTABLE. And they worry about our going out in term, which we were prepared to do in selected cases, and that would hurt them to match those terms.

Mr. LANGE. To add to the banks, intervening was the joint resolution of Congress, and the Neal-Heinz bill; all these things were gathering steam and were watched very closely—I am sure this hearing today is being watched.

Mr. LAGOMARSINO. If the Europeans feel it was in their interest to accept an interim agreement, do you expect them to accept a more realistic export figure for a final agreement?

Mr. LANGE. As the old saying goes, "he who lives by the crystal ball had better learn to eat glass." I am not trying to be facetious; I just do not have an answer.

Mr. LAGOMARSINO. Will it change our negotiating position if interest rates drop significantly next year?

Mr. LANGE. The entire program of the Reagan administration has been geared so that we can finally begin to see a drop in interest rates. As the cost of money drops to the U.S. Government, and the export credit interest rates we are trying to negotiate move up, the problem will be much reduced.

Mr. LAGOMARSINO. But I guess you still have the problem to some extent, because if the official borrowing rate is 10 percent and you can get it from the Government for 7, you are that much better off, but certainly it would not be as acute a problem as it is now. Ms. Constable, could you elaborate on your comments regarding the role of official export finance? Do you mean that aircraft sales and nuclear sales should be the main beneficiaries, or are you thinking of other things?

ROLE OF OFFICIAL EXPORT FINANCE

Ms. CONSTABLE. No, and I did not intend to imply that. I simply want to emphasize as the thrust of all of our testimony and the objective of the negotiations is to place limits on export credits, that is to say the subsidies. It is important to recognize that export financing is in some cases one of the imperfections. For example, on aircraft, as you know, Mr. Draper is limiting rather substantially the financing for certain types of aircraft on the grounds that it is not required for those transactions to be competitive, but at an earlier stage of the process it was important to provide this financing to get the sales.

Could I just make one comment on our negotiating position and the effect that falling interest rates would have on that position? It is our hope that if U.S. rates indeed do go down that some of the earlier proposals for dealing with the problem would become more attractive to the Europeans. A moving rate is tied to individual country rates, which they have been resisting. If our rates went down——

Mr. LANGE. That would lead to a differentiated interest rate system. We see declining rates as completely in our favor for reaching our goals.

Mr. BINGHAM. Mrs. Fenwick.

Mrs. FENWICK. What can you tell us about the gentlemen's agreement? Was that by and large lived up to pretty well, or was it by and large completely ignored?

Mr. LANGE. It is a difficult agreement to ignore. The information exchange system in the Arrangement on Export Credits permits the Export-Import Bank, for example, to make an inquiry, say of Germany: Have you been approached by a foreign business and government of country *x* for this project? How would Eximbank know to ask that question? The U.S. salesman is out there in that country trying to sell, and obviously he is going to find out that he has competition. Then the German Government is obligated to cable back if they have been approached and answer the questions, what are you offering, and at what terms and conditions? That gives Eximbank a chance to match if it wants to. Thus Germany and other countries have replied.

Mrs. FENWICK. They have replied. Because in the earlier meetings of the committee we did hear that country *x* was offering longer terms than what had been agreed upon—I am sure you remember those difficulties.

Mr. LANGE. This still goes on. We get these reports all the time, and if the buyer is smart, he is going to build that story up as much as he can in hopes somebody will break and say all right, we will match it.

Mrs. FENWICK. What is this interim agreement that is referred to as not covering enough industries in this country and so on? We have had reference to an interim agreement. What is that interim agreement? Or are we misinformed?

Mr. LANGE. I am not sure I can answer your question, Mrs. Fenwick. It may be that what we referred to is a breakthrough on the arrangement trying to move rates up from 10 percent to much higher, toward market conditions is a process, not something that has been completed.

I don't know if that answers your question.

Mrs. FENWICK. Do you exclude any sections of trade other than the ones that you have excluded, aircraft and nuclear plants?

Mr. LANGE. Only agriculture and the military.

Mrs. FENWICK. And that is all?

Mr. LANGE. Yes, ma'am.

Mrs. FENWICK. I see. Agriculture, military, aircraft, and nuclear?

Mr. LANGE. Yes.

Mrs. FENWICK. Thank you, Mr. Chairman.

Mr. BINGHAM. Mr. Gilman.

Mr. GILMAN. Thank you, Mr. Chairman.

EXCLUSION OF AGRICULTURAL TRADE FROM ARRANGEMENT

Speaking to the agricultural trade aspects, you say they are excluded from the provisions of the agreement?

Mr. LANGE. Yes, sir.

Mr. GILMAN. How will they be handled?

Mr. LANGE. From time to time the issue comes up as to whether we should bring agriculture into the arrangement for export credits. For the most part it is the U.S. Government that offers longer term credits than any other government. It is the GSM102 program, the 3-year guarantee program under the Commodity Credit Corporation. Most countries don't offer those kinds of terms and conditions.

We would have thought that our major competitors in wheat, for example, such as Canada or Australia, would raise this issue, but they have had as little desire to raise it as we have had.

Mr. GILMAN. There has been some growing attention to doing something about some of the commodities where we are not in a competitive position with some of our neighbors—Canada, for example.

Are we exploring some methods of financing those exports?

Mr. LANGE. Not in terms of an international agreement, Mr. Gilman, because we usually take the lead as far as agricultural export finance goes, as a government, in providing financing arrangements.

Ms. CONSTABLE. But some of those issues were addressed and could well be readdressed in the discussions relative to the international wheat agreement. I don't want to get into too much detail here as this is not in my portfolio and my colleagues on the commodity side will have my head; but those issues have been addressed in that context in discussions with Canada and Australia. I assume they will come up again.

Mr. LANGE. In the context of establishing a common line for finance, we have had discussions about it, but there has been no desire by major governments to establish any agreement.

Mr. GILMAN. Or by our own government?

Mr. LANGE. No, sir.

DIMINISHED NEED FOR LEGISLATION

Mr. GILMAN. Now, do I understand that there is no longer any need for the war chest legislation?

Mr. LANGE. Well, we have given you a sort of a "yes and no" answer. I will put it very bluntly. The rates on export credits—the minimum rates now for the dollar and the French franc and pound sterling is 10 percent—are really not close to the cost of money to the treasury of these countries.

We feel we have the train moving now to get rates up in March and May. Thus, we would hesitate to say that we need the war chest bill now. But if things don't turn out the way we want we would hope that it might be possible for the Congress to reconsider that.

Mr. GILMAN. That is a billion dollars that we are talking about; right?

Mr. LANGE. Yes, sir.

Mr. GILMAN. Under what appropriation would that come?

Mr. LANGE. I don't——

Mr. GILMAN. Has that been deleted now?

Mr. LANGE. It has not gone to the floor. I think the committees have reported it out; that is the House Banking and Senate Banking Committees. I don't think the bills have gone to any appropriations committees, however.

Mr. GILMAN. That is not part of this bill?

Ms. CONSTABLE. That is a separate one.

Mr. GILMAN. Is the billion dollars now before us in any shape or form?

Mr. BINGHAM. Not before our committee.

Mr. GILMAN. I realize that, but is it included in any of our budgetary considerations?

Mr. LANGE. No, sir.

Mr. GILMAN. It is still in a proposal stage?

Mr. LANGE. It is still in a proposal stage and has been discussed and reported out by the authorizing committees, the House Banking and Senate Banking Committees.

Mrs. FENWICK. Mr. Gilman——

Mr. GILMAN. If I may pursue that further.

If there is no need for it, are you going to withdraw the request?

Mr. LANGE. We did not request it. It was an initiation made by the House and by the Senate.

Mr. GILMAN. You are recommending that there is no further need for the war chest bill?

Mr. LANGE. Not at this time.

Mr. GILMAN. I think we would all be pleased to take a billion dollars and apply it elsewhere. I hope you will let the Appropriations Committee know that there is no need for that.

Mr. LANGE. Yes, sir. We have done so informally and Treasury has an obligation in its budget to make a formal report in December.

IMPACT OF AGREEMENT ON U.S. TRADE POSITION

Mr. GILMAN. One other question. How much of an impact on U.S. imports and trade position do they expect to result from this agreement?

Mr. LANGE. I don't know how to answer that.

Mr. GILMAN. Are there some real pluses involved?

Mr. LANGE. There are in this sense: Once these financial subsidies are eliminated, U.S. firms which are price competitive in the servicing, marketing, and in the quality of their products, will not be undermined by less competitive firms abroad which now have financial subsidy supports from their governments.

In that regard, the whole economic program aimed at making our firms more productive, will reap the benefits of not having to face foreign official credit subsidies.

To put a number to it, though, to say, what that is worth in dollars and cents in trade, I am not sure I can answer that.

Mr. GILMAN. Let me understand—you are saying they would not be undermined if we did not have this?

Mr. LANGE. If we eliminate Federal credit subsidies worldwide, the principles of comparative trade advantage will be able to work; free market forces will be able to work.

This particular form of government intervention—official export credit subsidies—this particular distortion of trade, will be eliminated. In our judgment the consumer and the producer alike will benefit from that worldwide, including our producers and our consumers.

Ms. CONSTABLE. And the Export-Import Bank with limited resources could direct its programs to those areas where there are market imperfections outside of the competitive subsidy game and limited resources would go much further in promoting exports.

Right now an enormous amount of money that Eximbank uses is chewed up by matching credits.

Mr. GILMAN. What will this program cost our Government?

Ms. CONSTABLE. Which program?

Mr. GILMAN. The agreements that you are talking about.

Mr. LANGE. It saves money.

Mr. GILMAN. There won't be any cost?

Mr. LANGE. No. It is a negative cost a positive gain. It is difficult to measure what that gain is, except as Ms. Constable said, it saves the amount of money that we might otherwise put into the Eximbank or into a war chest bill.

Mr. GILMAN. What savings will we get for the Eximbank?

Mr. LANGE. No, It is a negative cost, a positive gain. It is difficult gress in its wisdom wishes them to have, Eximbank will be able to lend at a profit.

During the past several years, in order to match foreign official credit competition, Eximbank has had to lend at a substantial loss, so that the chairman now predicts that this fiscal year the bank may run a deficit as large as $200 million, followed by $400 million and $600 million in the following 2 years if the cost of money to the bank stays at 15.5 percent.

That cost of money is going down now, so a 15.5 percent assumption is a worst case possibility. If we eliminate export credits subsidies and are able to lend at the cost of money to the Government and slightly more, the bank will be able to be on a good business footing and regain its capital position.

Mr. GILMAN. Thank you.

Mr. BINGHAM. Mrs. Fenwick.

Mrs. FENWICK. I have a small question of the State Department. On page 2 of the bill—do you have a copy of the bill?

Ms. CONSTABLE. No.

Mrs. FENWICK. The first line of the third paragraph. It seems to me very inappropriate.

Mr. LANGE. Oh, yes.

Mrs. FENWICK. I think that could be left out wisely, don't you?

Ms. CONSTABLE. Well, as a diplomat I have to agree with you.

Mrs. FENWICK. I thought that perhaps you might.

Ms. CONSTABLE. Even though it happens to be true.

Mrs. FENWICK. I am sure, because we have had that before.

Mr. BINGHAM. Let me ask one or two more questions. Are there any sanctions provided within the OECD mechanism for violations of the agreement?

Mr. LANGE. No, sir. There are no sanctions employed. What is provided—the basic element that makes the agreement work—is the exchange information and the abilities of countries to match.

COOPERATIVE ACTIONS BY JAPANESE GOVERNMENT

Mr. BINGHAM. The special problem posed for Japan which has lower interest rates, domestic interest rates—how is that a factor?

Mr. LANGE. We are deeply grateful to the Government of Japan for their forbearance and their cooperation last month in agreeing to charge a minimum interest rate of 9.25 percent, which is actually higher than the long-term prime rate in their commercial market. That is now 8.9 percent.

Japan did this in the interest of reaching an accord for the sake of other countries and also to gain the principle of differentiation for low-interest-rate currencies.

We stand very strongly behind the Japanese in their effort (1) to move to a differentiated interest rate system and (2) to get high interest rate countries to move their rates up to market rates. Indeed, this is one area in international trade where we and the Japanese agree completely.

CONSIDERATION OF H. CON. RES. 95

Mr. BINGHAM. We have had some comments from the U.S. industries that are somewhat critical of the new interim agreement. I would like, however, to report out the resolution, if that is all right with you, Mrs. Fenwick.

Mrs. FENWICK. Could I make a suggestion in the resolution?

Mr. BINGHAM. It has been reported out in its present form by the Ways and Means and Banking Committees.

Mrs. FENWICK. Why can we not amend it?

Mr. BINGHAM. It creates a complication if we do because then the other committees would have to go back—do you feel strongly about it?

Mrs. FENWICK. Yes. For the Foreign Affairs Committee to release such an attack on a single government is gratuitous and unwise.

Mr. LAGOMARSINO. Especially when they cooperated.

Mrs. FENWICK. It is just the kind of gratuitous insult that we don't need to express. I would feel very sorry to see the Foreign Affairs do it, but the Banking Committee is a little bit insensitive.

Mr. BINGHAM. Let me schedule another meeting to discuss that. I take your point and it is well taken.

Mr. LAGOMARSINO. Mr. Chairman, I might suggest that the staff—I think they have talked about this a little already—get together and at least make some suggestions for bringing this up to date.

When it was written I am sure it was exactly right. We argue whether France should have been mentioned, but it was accurate and now it is a little bit out of date. As the President's Congressman, I think we ought to recognize that they have been doing some of the things we were asking them to do.

Mr. GILMAN. To save some time, why don't we report it out as amended and if you have to come back for further consideration——

Mr. BINGHAM. We don't have an amendment. I would like to see the staff work out appropriate language. We have time enough.

I just have two or three more questions, but we won't take any action.

Mrs. FENWICK. Thank you.

CRITICISM OF MINIMUM INTEREST RATES

Mr. BINGHAM. I was asking about the comment that we have heard from industries to the effect that the agreed minimum interest rates are still below those offered by the Eximbank. Is that criticism legitimate?

Mr. LANGE. On the face of it, Mr. Chairman, they seem so, but when one looks into it a little more carefully, those criticisms are mitigated in the following way.

The Europeans system of repayment on their loans, official and private loans, is a straight-line amortization schedule. A 10-year loan, for example, is amortized semiannually, principal and interest, on a straight-line basis for 10 years.

The Eximbank of the United States, in contrast has the ability to hold its repayment of principal for several years on its share of the total financing of the export. For example, if it finances 60 percent of the export and private banks finance 40 percent for 10 years, 60 percent of the financing can be at a 12-percent interest rate but the payment of that 60 percent—the principal—will not be coming due until maybe the last 5 years, whereas the 40 percent financing done by private banks, without any participation by Eximbank, will be at something floating over prime but paid off in the first 5 years.

So in a nutshell what happens is that the dear money is paid off first, the cheap money paid off second. The total effective cost of money, therefore, is less than it would be if the 10-percent rate were applied straight line and the high interest rate money was applied straight line for 10 years.

It is a long way of explaining that Eximbank can charge a higher rate than 10 percent and still be competitive.

Mr. BINGHAM. I see. Thank you.

MIXED CREDITS

There is also a comment that the agreement doesn't cover the mixed credits. Could you go into that a little bit? What are these mixed credits and how do they relate to cofinancing and parallel financing?

Mr. LANGE. Yes, sir. The agreement does refer to mixed credits and the reference is to provide notification if a mixed credit is given. A mixed credit was defined for this purpose as an export credit mixed with foreign aid. Anything over 15-percent grant element up to 25 percent, requires notification after—correct me if I am wrong—after the mixed credit had been given.

Under the current agreement, as a result of the recent negotiation, the Europeans said if a mixed credit with a grant element even up to 25 percent is given, countries will notify each other before giving it so that others will have a chance to match it. Moreover, they will report mixed credits with grant elements in excess of 25 percent.

Now, there was some question as to whether how much in excess, a 100-percent grant or 90 or 80 or 40. That remains an open question. Still, there is a system now whereby, if a country is doing the mixed credit, which is really bothering the commercial sector, thereby undermining a price competitive firm, we will have a chance to match the mixed credit.

Mr. BINGHAM. Match it, though, with grants——

Mr. LANGE. From the United States. Eximbank has done this from time to time in cases which are particularly egregious.

Mr. BINGHAM. Where did the grants come from?

Mr. LANGE. Eximbank. The bank has done it by granting two loans, one portion of the loan at a normal lending rate and the other portion, a subloan, at 3-percent lending rate. The bank has a broad flexibility in its ability to lend.

Mr. BINGHAM. So when countries are engaged in that sort of mixed financing they are really engaged in a distinct aid program in addition to promotion of exports?

Mr. LANGE. Some are. I should clarify this issue, Mr. Chairman. There has been a great deal of misunderstanding, even within the executive branch, as to what bothers us about mixed credits. We recommend that people not be bothered so much about, say, French mixed credits in sub-Saharan Africa. They help stretch the aid credits there. But for a commercial project, mixed credits are inappropriate and they are not really development loans in the true sense of the word in Mexico or Brazil or advanced developing countries. That is what we are talking about when we get concerned about mixed credits, not the idea of using them in the poorest of countries. Mixed credits in newly industrialized countries do not happen very often, but they appear enough to bother some. And, in some cases, we have matched them.

Ms. CONSTABLE. If I could say a word on this. There are cases where mixed credits do make sense. In fact, we have used them ourselves on occasion. A recent example is a $25 million mixed credit to Egypt. In that case the objective was to try and move some balance-of-payments support that was clogged in the pipeline but it was an exception.

As a general proposition, in addition to the commerical problem posed by the use of mixed credits with other governments, we question—perhaps it needs a closer look—but we question the validity of mixing up aid and commercial objectives in a generalized way without proceeding very, very carefully. At the moment, with the limited resources available, our inclination is to be very, very selective.

Mr. BINGHAM. One final question. In these negotiations that deal with the members of the EC as separate nations, you don't negotiate with the community?

Mr. LANGE. No, sir. We negotiate with the community.

Mr. BINGHAM. You do?

Mr. LANGE. Yes, sir. In the International Arrangement on Export Credits, the most recent negotiator was Jose Loeff, who is of the Commission staff. In the aircraft common line, we did not negotiate with the Commission; we negotiated with three airbus partners.

Mr. BINGHAM. Who are Britain, France, and what?

Mr. LANGE. And Germany.

The Europeans referred to this as a unilateral declaration of policy by each individual government, that happens to be harmonious. It all has to do with their obligations under the Treaty of Rome. I guess the reason it was done this way was because it was quick and effective. It was all very informal.

Mr. BINGHAM. Thank you very much.

Are there any other questions?

Mr. Mica? Mr. Roth?

Thank you very much. I appreciate your being with us.

The subcommittee is adjourned.

[Whereupon, at 3:45 p.m., the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

97TH CONGRESS
1ST SESSION

H. CON. RES. 95

To encourage the reduction of export credit subsidies in world trade.

IN THE HOUSE OF REPRESENTATIVES

MARCH 18, 1981

Mr. NEAL submitted the following concurrent resolution; which was referred jointly to the Committees on Banking, Finance and Urban Affairs, Foreign Affairs, and Ways and Means

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CONCURRENT RESOLUTION

To encourage the reduction of export credit subsidies in world trade.

Whereas the expansion of exports by the United States promotes national security and economic growth;

Whereas export financing by the Export-Import Bank has increased exports from the United States and helped make United States products competitive with those of other nations;

Whereas some governments offer fir ıncing for their own exports at highly subsidized interest rates that the Export-Import Bank finds difficult to match, and which can be matched only by imposing high costs on the American taxpayer;

Whereas some governments are also increasing their offers of mixed credit financing in which foreign aid is blended with official export credit to finance exports at extremely subsidized interest rates;

Whereas the United States and some other nations have tried to engage in serious negotiations to restrain export credit competition and to reduce the extent of export credit subsidies;

Whereas some of our foreign competitors, including the French Government, have refused to negotiate seriously to reach a satisfactory agreement to reduce export credit subsidies, and presist in offering highly subsidized credit to their own exporters in competition with American exporters, despite agreement by the heads of government at the 1980 economic summit that those negotiations should be concluded to the mutual satisfaction of all participants by the end of 1980;

Whereas the President of the United States, in order to promote a healthy national economy, has proposed cuts in Federal spending, including reduction of the lending authority of the Export-Import Bank: Now, therefore, be it

Resolved by the House of Representatives (the Senate concurring), That it is the sense of the Congress that the President of the United States should try to secure the agreement of other nations to reduce significantly the extent of export credit subsidies now granted by members of the Organization for Economic Cooperation and Development;

That the President should make this issue a matter of high priority in our diplomatic and economic relations with those governments;

That the President should consider employing whatever tools of trade policy stand at his disposal, consistent with domestic and international law, in order to counter and offset the economic consequences of excessive export credit subsidies granted by foreign governments, and to induce those governments to negotiate seriously to reduce those subsidies;

That the Export-Import Bank, in carrying out its mandate to neutralize foreign competition in official export credit, should establish as its first and dominant priority the use of its available resources to counter and offset the subsidies granted by those foreign governments, including the French, who have been most reluctant to negotiate a serious and meaningful reform of the "Arrangement on Guidelines for Officially Supported Export Credits".